THE RENEWABLE ENERGY AND ENERGY CONSERVATION TAX ACT OF 2007
H.R. 2776

Earlier this year, Congress made a promise when it passed H.R. 6, the CLEAN Energy Act of 2007, to use funds raised from repealing tax breaks for the oil and gas industry for the following purposes: (1) to accelerate the use of clean domestic renewable energy sources and alternative fuels, (2) to promote the use of energy-efficient products, practices and conservation and (3) to increase research, development and deployment of clean renewable energy and efficiency technologies. The Renewable Energy and Energy Conservation Tax Act of 2007 (H.R. 2776) makes good on this promise.

The Renewable Energy and Energy Conservation Tax Act of 2007 would accelerate the use of clean domestic renewable energy sources and alternative fuels. The bill provides long-term tax incentives encouraging the production of electricity from renewable energy -- including energy derived from wind, solar, biomass, geothermal, river currents, ocean tides, landfill gas, and trash combustion resources. The bill also provides tax incentives for the production of renewable fuels such as cellulosic alcohol, biodiesel and renewable diesel.

The Renewable Energy and Energy Conservation Tax Act of 2007 would promote the use of energy-efficient products, practices and conservation. The bill includes tax incentives for manufacturers to build appliances that push the boundaries of efficiency, helps working families afford fuel-efficient plug-in hybrid vehicles, and includes incentives for businesses to create energy-efficient workplaces. The bill creates a new partnership between the Federal government and State and local governments that would provide local leaders with the ability to raise interest-free funds to implement a broad range of energy conservation programs such as investing in mass transit, constructing bicycle trails, and encouraging the development of green buildings.

Finally, the Renewable Energy and Energy Conservation Tax Act of 2007 would increase research, development and deployment of clean renewable energy and efficiency technologies. The bill provides State and local governments with the ability to raise interest-free funds to invest in research facilities and to make research grants to support research in, among other things, the development of cellulosic ethanol, technologies for the capture and sequestration of carbon dioxide, and automobile battery technologies. The bill encourages the deployment of renewable energy by providing electric cooperatives and public power providers with new clean renewable energy bonds that will allow these entities to install facilities that would generate electricity from renewable resources. It also provides States with the ability and incentive to implement low-interest loan programs and grant programs that will help working families purchase energy-efficient appliances, make energy-efficient home improvements, or install solar panels, small wind turbines, and geothermal heat pumps.

<u>LETTERS OF SUPPORT FOR H.R. 2776</u>

(As of August 2, 2007)

1. Air Conditioning Contractors of America
2. Alliance to Save Energy
3. American Council For An Energy Efficient Economy
4. American Institute of Architects
5. American Public Power Association
6. American Standard
7. American Wind Energy Association
8. American Water Works Association
9. Appliance Standards Awareness Project
10. ASHRAE
11. Association of Energy Engineers
12. Association of Home Appliance Manufacturers
13. Association of Metropolitan Water Agencies
14. Audubon
15. Austin Energy/City of Austin
16. Biotechnology Industry Organization
17. Clean Water Action
18. Concentrating Solar Power Industry
19. Defenders of Wildlife
20. Earthjustice
21. Edison Electric Institute
22. Energy & Engineering Solutions, Inc.
23. Friends of the Earth
24. Friends Committee on National Legislation
25. GAMA - Association of Appliance & Equipment Manufacturers
26. General Electric
27. Geothermal Energy Association
28. Greenpeace
29. Imark Group
30. International Association of Lighting Management Companies
31. International Council of Shopping Centers
32. The Large Public Power Council
33. MCAA - Mechanical Contractors Association of America
34. National Association of Electrical Distributors
35. National Association of Industrial & Office Properties

36. National Biodiesel Board
37. National Electrical Contractors Association
38. National Electrical Manufacturers Association
39. National Electrical Manufacturers Representatives Association
40. National Environmental Trust
41. National Ethanol Vehicle Coalition
42. National Hydropower Association
43. National Lighting Bureau
44. National Roofing Contractors Association
45. National Renderers Association
46. National Rural Electric Cooperative Association
47. National Wildlife Federation
48. Natural Resources Defense Council
49. Northeast Energy Efficiency Partnerships
50. Ocean Renewable Energy Coalition
51. One Source Associates
52. Physicians for Social Responsibility
53. Polyisocyanurate Insulation Manufacturers Association
54. Public Citizen
55. Sierra Club
56. Sheet Metal and Air Conditioning Contractors' National Association
57. Solar Energy Industries Association
58. Soap and Detergent Association
59. Spray Polyurethane Foam Alliance
60. TechNet
61. Union of Concerned Scientists
62. U.S. Fuel Cell Council
63. U.S. PIRG
64. Verenium Corporation
65. Whirlpool
66. The Wilderness Society

OIL AND GAS PROVISIONS IN H.R. 2776
THE RENEWABLE ENERGY AND ENERGY CONSERVATION TAX ACT OF 2007

In addition to the $16 billion in renewable energy incentives and energy conservation provisions contained in H.R. 2776, the bill ends some of the tax breaks the oil and gas industry received in 2004 and 2005. These provisions were included in H.R. 6, which passed the House of Representatives with overwhelming bipartisan support in January. H.R. 2776 also closes a loophole that allows the oil industry to shift the cost of foreign oil extraction taxes away from oil companies and onto American taxpayers.

G&G EXPENSING/REPEAL OF SECTION 199 DEDUCTION (As Passed in H.R. 6, the CLEAN Act)

The oil and gas industry was provided tremendous tax breaks during a period of record profits. Between 2004 and 2006, profits for the big five oil companies have risen an average of 62% — some companies have seen as much as a 117% rise in profits. Even President Bush's budget criticizes proposals to expand tax incentives for the oil and gas industry, stating that "Current high energy prices are already providing significant incentives for companies to invest in oil and gas exploration. The Energy Act provisions expanding tax incentives for oil and gas exploration are not necessary."

These previously House-passed provisions would eliminate one major tax break for oil and gas companies and would minimize the revenue loss of another major tax break for large integrated oil companies.

- G&G Expenses: Oil and gas companies are entitled to deduct over two years (five years in the case of large integrated oil companies) the cost of geological and geophysical (G&G) expenses paid or incurred in connection with the exploration for, or development of oil or gas within the United States. Similar expenses by nonextraction businesses would be capitalized. The bill replaces the 5-year period currently allowed in the case of large integrated oil companies with a 7-year period.

- Domestic Production Activities Deduction: The domestic production activities deduction was adopted in 2004 as a replacement for the FISC-ETI tax benefit for exports that was challenged by the European Union in the World Trade Organization. When the domestic production activities deduction was adopted, it was extended to the oil and gas industry even though the oil and gas industry had never previously qualified for the FSC-ETI tax benefit. H.R. 6 would provide that the domestic production activities deduction would not apply to the sale, exchange or other disposition of oil, natural gas, or any primary product thereof. These same products were previously ineligible for the FSC-ETI tax benefits. This change should not significantly impact oil and gas companies that reinvest their earnings in the United States because these companies will continue to qualify for numerous other tax benefits (such as the benefits outlined on the next page).

***H.R. 2776 L**EAVES* ***U**NTOUCHED* ***S**IGNIFICANT TAX BREAKS IN THE FORM OF CREDITS AND DEDUCTIONS FOR THE OIL AND GAS INDUSTRY*

- Intangible Drilling Costs: When an oil company or a gas company spends money to create an oil or gas well in the United States, it is entitled to an immediate deduction for many of the costs of drilling and preparing the well for the production of oil or gas (often 60% to 85% of the cost of a well). Integrated companies (those with both production and refining or marketing) can only deduct 70% of these costs immediately and they can deduct the other 30% over five years. In contrast, similar expenses incurred by non-extraction businesses would be capitalized and depreciated over time (which could be up to 39 years for real property).

- G&G Expenses: As described above, oil and gas companies are entitled to deduct the cost of geological and geophysical (G&G) expenses paid or incurred in connection with the exploration for, or development of oil or gas within the United States. Similar expenses by non-extraction businesses would be capitalized. Under the bill, this tax break would continue for all oil and gas companies (although large integrated oil companies would be required to deduct over a seven-year period).

- Percentage Depletion: Businesses are able to take deductions recovering the cost of their capital assets. This is accomplished through depreciation or depletion (in the case of natural resources). Some oil and gas companies are allowed to take deductions well in excess of cost through percentage depletion as opposed to cost depletion. Under percentage depletion, a taxpayer is entitled to take a deduction equal to a percentage of the income generated by the wells owned by the taxpayer. As a result, percentage depletion is tantamount to a reduction in tax rate.

- Refinery Deduction: In 2005, oil companies were permitted to deduct 50% of the cost of certain assets used in oil refineries in the United States that would otherwise be capitalized. This tax benefit was given to oil companies despite the fact that, in 2004 and 2005, refiner margins for gasoline were over 40 cents per gallon (the highest in over fifteen years).

REPEAL OF LOOPHOLE FOR RECHARACTERIZATION OF FOREIGN OIL AND GAS EXTRACTION INCOME

- The oil and gas industry enjoys far lower taxes in the United States than they face in other parts of the world. Because of higher taxes in foreign countries, Exxon Mobil paid $4.7 billion more in taxes in 2005 on its non-U.S. income than it would have paid if this income was subject to the maximum Federal tax rate of 35%. Indeed, it appears that some countries have increased their taxes in response to higher oil and gas prices.

- Under current law, royalties paid to a foreign country for the privilege of extracting oil or gas in that country, are deductible expenses, reducing U.S. tax by a maximum of 35 percent of the royalty payment. But, foreign income taxes imposed with respect to income from oil or gas extraction are creditable foreign taxes, potentially reducing U.S. tax on a dollar for dollar basis. Obviously, there is a clear incentive for foreign countries to convert royalty payments into income taxes, and that is what most foreign countries have done.

- Congress responded to the potential tax avoidance from converting royalties into income taxes by enacting Section 907 which limits the ability to claim the foreign tax credit for taxes imposed on extraction income. Section 907 attempts to limit the foreign tax credit for those taxes to 35 percent of the income from foreign oil and gas extraction. As a result, in the absence of avoidance techniques, there would be no residual U.S. tax on foreign extraction income, but the taxes on that income could not be used to reduce the U.S. tax on other foreign income.

- In some cases, companies are understating their foreign extraction income and the amount of taxes imposed on that income. The proposal would simply state that taxes imposed by foreign countries on extraction income would be allocated to that income for U.S. tax purposes. This would prevent avoidances of the current-law Section 907 limits.

- **This provision has NO IMPACT on oil and gas production in the United States. Without this provision, the U.S. Treasury, not the oil companies, would continue to bear the burden of what are typically very high foreign tax rates on oil and gas extraction income.**

H.R. 2776
Renewable Energy and Energy Conservation Tax Act of 2007

July 31, 2007

I. PRODUCTION INCENTIVES

Long-term extension and modification of renewable energy production tax credit. The bill extends the placed-in-service date for four years (through December 31, 2012) for qualifying facilities: wind; closed-loop biomass; open-loop biomass; geothermal; small irrigation hydropower; landfill gas; and trash combustion facilities. It also includes a new category of qualifying facilities -- facilities that generate electricity from marine renewables (e.g., waves and tides). The bill would cap the aggregate amount of tax credits that can be earned for qualifying facilities placed in service after December 31, 2008 to an amount that has a present value equal to 35% of the facility's cost. *This proposal is estimated to cost $6.58 billion over 10 years.*

Long-term extension and modification of solar energy and fuel cell investment tax credit. The bill extends the 30% investment tax credit for solar energy property and qualified fuel cell property for eight years (through the end of 2016). It also increases the $500 per half kilowatt of capacity cap for qualified fuel cells to $1,500 per half kilowatt of capacity. The bill removes an existing limitation that prevents public utilities from claiming the investment tax credit. *This proposal is estimated to cost $563 million over 10 years.*

New Clean Renewable Energy Bonds ("CREBs"). The bill authorizes $2 billion of new clean renewable energy bonds for public power providers and electric cooperatives. Sixty percent of the authorization must be used for qualifying projects of public power providers and forty percent must be used for qualifying projects of electric cooperatives. Qualifying projects include facilities that generate electricity from the following resources: wind; closed-loop biomass; open-loop biomass; geothermal; small irrigation hydropower; landfill gas; and trash combustion facilities. *This proposal is estimated to cost $550 million over 10 years.*

Sales of electric transmission property. The bill extends the present-law deferral on sales of transmission property from electric utilities and their affiliates to a FERC-approved independent transmission company. Rather than paying tax on any gain from the sale in the year the sale is completed, electric utilities and their affiliates will have 8 years to pay the tax on any gain from the sale. The rule expires January 1, 2010. *This proposal is revenue neutral over 10 years.*

Residential energy-efficient property. The bill removes the caps on the credit for residential solar property (currently capped at $2,000) and residential fuel cell property (currently capped at $500 per half kilowatt of capacity). The bill also allows the credit to be used to offset alternative minimum tax (AMT). *This proposal is estimated to cost $89 million over 10 years.*

II. CONSERVATION

TRANSPORTATION

Plug-in hybrid vehicle credit. The bill establishes a new credit for each qualified plug-in vehicle placed in service during each taxable year by a taxpayer. The base amount of the credit is $4,000. If the qualified vehicle draws propulsion from a battery with at least 5 kilowatt hours of capacity, the credit amount is increased by $200, plus another $200 for each kilowatt hour of battery capacity in excess of 5 kilowatt hours up to 15 kilowatt hours. Taxpayers may claim the full amount of the allowable credit up to the end of the first calendar quarter after the quarter in which the manufacturer records 60,000 sales. The credit is reduced in following quarters. The credit is available against the alternative minimum tax (AMT). *This proposal is estimated to cost $1.22 billion over 10 years.*

Cellulosic alcohol production credit. The bill creates a new production tax credit of 50 cents per gallon for cellulosic alcohol produced for use as a fuel in the United States. This credit is in addition to the current 51 cents per gallon ethanol credit and the 10 cents per gallon small producer credit. The credit is available through the end of 2010. *This proposal is estimated to cost $24 million over 10 years.*

Extension of biodiesel production tax credit; extension and modification of renewable diesel tax credit. The bill extends for two years (through December 31, 2010) the $1.00 and 50 cent per gallon production tax credits for biodiesel and the small biodiesel producer credit of 10 cents per gallon. The bill also extends for two years (through December 31, 2010) the $1.00 per gallon production tax credit for diesel fuel created from biomass. The bill eliminates the requirement that the diesel fuel must be produced using a thermal depolymerization process. As a result, the credit will be available for any diesel fuel created from biomass without regard to the process used. The bill also requires the diesel fuel to be usable as a fuel in vehicles. *This proposal is estimated to cost $279 million over 10 years.*

Extension and increase of alternative refueling stations tax credit. The bill increases the 30% alternative refueling property credit (capped at $30,000) to 50% (capped at $50,000). The credit provides a tax credit to businesses (e.g., gas stations) that install alternative fuel pumps such as fuel pumps that dispense E85 fuel. The bill also extends this credit through the end of 2010. *This proposal is estimated to cost $184 million over 10 years.*

Fringe benefit for bicycle commuters. The bill allows employers to provide employees that commute to work using a bicycle limited fringe benefits to offset the costs of such commuting (e.g., bicycle storage). *This proposal is estimated to cost $10 million over 10 years.*

Modification of depreciation and expensing rules for certain vehicles. The bill would eliminate a loophole in the tax law that provides businesses with tax benefits if they purchase heavy vehicles that are often less fuel efficient (e.g., large sports utility vehicles (SUVs)) rather than lighter, more fuel efficient vehicles. The bill would retain these existing tax benefits for vans that are designed for strictly business use and trucks. The bill would also retain existing tax benefits for heavy vehicles (and extend these tax benefits to lighter, generally more fuel-efficient vehicles) that are used in the following businesses: (1) transporting persons or property for compensation or hire; (2) farming; (3) transporting a substantial amount of equipment, supplies or inventory; and (4) moving or delivering property which requires substantial cargo capacity. *This proposal is estimated to raise $786 million over 10 years.*

Restructuring of New York Liberty Zone tax credits. The bill would implement a proposal included in the President's FY 2008 Budget to provide the City of New York and the State of New York with tax credits for expenditures made for transportation infrastructure projects connecting with the New York Liberty Zone. *This proposal is estimated to cost $1.636 billion over 10 years.*

OTHER CONSERVATION PROVISIONS

Qualified energy conservation bonds. The bill creates a new category of tax credit bonds for green community programs and initiatives designed to reduce greenhouse gas emissions. There is a national limitation of $3.6 billion which is allocated to States and municipalities. *This proposal is estimated to cost $1.46 billion over 10 years.*

Qualified energy efficiency assistance bonds. The bill creates a new category of tax credit bonds to provide States with funds to implement long-term programs that will provide consumers with low-interest loans and grants for energy-efficient property and efficiency improvements to existing homes. There is a national limitation of $2.4 billion. *This proposal is estimated to cost $903 million over 10 years.*

Extension of energy-efficient commercial buildings. The bill extends the energy-efficient commercial buildings deduction for five years (through December 31, 2013). *This proposal is estimated to cost $901 million over 10 years.*

Modification and extension of energy-efficient appliance credit. The bill would modify the existing energy-efficient appliance credit and extend this credit for three years (through the end of 2010). *This proposal is estimated to cost $351 million over 10 years.*

Five-year depreciation for smart meters. The bill would allow electric utilities to depreciate smart electric meters over a five year period. *This proposal is estimated to cost $1.315 billion over 10 years*.

III. REVENUE PROVISIONS

DENIAL OF OIL AND GAS TAX BENEFITS

Denial of section 199 benefits for income attributable to domestic production of oil, natural gas or primary products thereof. The bill excludes gross receipts derived from the sale, exchange or other disposition of oil, natural gas, or any primary product thereof from the domestic production deduction. The domestic production deduction replaced an export subsidy that had been declared an illegal trade subsidy by the World Trade Organization. The prior export subsidy was not available for exports of oil, natural gas or any primary product thereof. When the domestic production deduction was enacted, this new benefit was extended to these products. As a result, the domestic production deduction became a new subsidy for the oil and gas companies. This bill repeals this subsidy for the oil and gas companies. This proposal was previously included in H.R. 6, which passed the House of Representatives by a vote of 264 to 163 (with 36 House Republicans joining 228 House Democrats in support). *This proposal is estimated to raise $11.427 billion over 10 years.*

7-year amortization of geological and geophysical expenditures for certain major integrated oil companies. The bill increases the amortization period for geological and geophysical expenditures (G&G costs) from five years to seven years for large integrated oil companies. This proposal was previously included in H.R. 6, which passed the House of Representatives by a vote of 264 to 163 (with 36 House Republicans joining 228 House Democrats in support). *This proposal is estimated to raise $103 million over 10 years.*

Clarification of foreign oil and gas extraction income. The tax code limits the ability of oil and gas companies to claim foreign tax credits with respect to foreign oil and gas extraction income. Because of this limitation, there is a potential for oil and gas companies to manipulate their extraction income in order to achieve beneficial results under U.S. foreign tax credit rules. The bill would eliminate this potential. The bill would require oil and gas companies to use the ascertainable independent market values at the nearest point to the well for which an independent market exists in calculating their foreign oil and gas extraction income ("FOGEI") and foreign oil related income ("FORI"). The bill would also require that where a foreign country collects foreign taxes that are limited in their application to taxpayers engaged in oil or gas activities that oil and gas companies treat these taxes as oil and gas extraction taxes subject to the FOGEI limitation. *This proposal is estimated to raise $3.562 billion over 10 years.*

CLARIFICATION OF ELIGIBILITY FOR CERTAIN FUEL CREDIT

Clarification of eligibility for renewable diesel credit. The bill clarifies that the $1 per gallon production credit for renewable diesel is limited to diesel fuel that is produced solely from biomass. Diesel fuel that is created by coprocessing biomass with other feedstocks (e.g., petroleum) will be eligible for the 50 cent per gallon tax credit for alternative fuels. *This proposal is estimated to raise $85 million over 10 years.*

Clarification that fuel credits are designed to provide an incentive for United States production. The bill clarifies that the per gallon tax incentives for biodiesel, renewable diesel and alternative fuels are incentives for the production of alternative fuels in the United States. The bill also clarifies that the per gallon tax incentives for alcohol fuels, biodiesel, renewable diesel and alternative fuels are limited to fuels that are produced for consumption in the United States. *This proposal is estimated to raise $109 million over 10 years.*

IV. OTHER PROVISIONS

STUDIES

Carbon audit of the tax code. The bill directs the Secretary of the Treasury to request that the National Academy of Sciences undertake a comprehensive review of the tax code to identify the types of specific tax provisions that have the largest effects on carbon and other greenhouse gas emissions and to estimate the magnitude of those effects.

Comprehensive study of biofuels. The bill directs the Secretary of the Treasury, in consultation with the Secretary of Agriculture and the Secretary of Energy and the Administrator of the Environmental Protection Agency, to request that the National Academy of Sciences produce an analysis of current scientific findings relating to the future production of biofuels and the domestic effects of a dramatic increase in the production of biofuels.

LABOR STANDARDS

Labor standards for certain projects financed with tax credit bonds. The bill provides that the Davis-Bacon labor standards will apply to projects financed with tax credit bonds.